

ILLINOIS COMMERCE COMMISSION 2010 DEC -3 A 11: 18

CHIEF CLERK'S OFFICE

ILLINOIS-AMERICAN WATER COMPANY

Petition for Authority to Incur Indebtedness )  
Not to Exceed \$39,000,000 and ) Docket No. 09-0427  
Approval of Affiliated Interest Transaction )

**SPECIAL REPORT – 3rd Quarter 2010**

TO THE ILLINOIS COMMERCE COMMISSION:

Pursuant to Administrative Code Section 240.20, Petitioner submits the following report for the period July 1 through September 30, 2010.

a) In respect to the issuance and sale of:

1) Capital Stock

A) and B) Not applicable.

2) Bonds and other securities

A) and B) Petitioner did not issue any securities during the reporting period pursuant to Docket No. 09-0427.

3) All classes of securities

A) Reported previously.

B) With respect to the \$25 million tax-exempt financing issued through the Illinois Finance Authority (IFA), when IAWC incurs expenditures associated with qualified projects, it can submit construction fund requisitions to the Trustee to receive reimbursement. As of September 30, 2010, IAWC has submitted one requisition to the Trustee, in the amount of \$2,979,444, and has, in turn, been reimbursed by this amount.

As noted in IAWC's 4<sup>th</sup> quarter 2009 report pursuant to this docket, filed with the ICC on February 25, 2010, the Company also issued a \$14 million Promissory Note, the terms of which were provided in that report.

C) As of September 30, 2010, the total issuance costs incurred by IAWC associated with the security authorization granted in Docket No. 09-0427 have been \$1,094,172.77. The itemization of this amount for each debt issuance is as follows:

**\$14 Million Taxable Bond Issuance on December 4, 2009**

| <b>Underwriter Fees</b> | <b>Legal Fees</b> | <b>Misc. Fees</b> | <b>ICC Fees</b> | <b>IFA Fees</b> | <b>Total Issuance Costs</b> |
|-------------------------|-------------------|-------------------|-----------------|-----------------|-----------------------------|
| \$441,000               | \$24,335.63       | \$42,335.20       | \$33,600        | N/A             | \$541,270.83                |

**\$25 Million Tax-Exempt Issuance on May 27, 2010**

| <b>Underwriter Fees</b> | <b>Legal Fees</b> | <b>Misc. Fees</b> | <b>ICC Fees</b> | <b>IFA Fees</b> | <b>Total Issuance Costs</b> |
|-------------------------|-------------------|-------------------|-----------------|-----------------|-----------------------------|
| \$125,000               | \$116,686.78      | \$58,715.16       | \$60,000        | \$192,500       | \$552,901.94                |

b) In respect to application of proceeds:

Proceeds from the \$25 million Promissory Note are being used to fund capital expenditures related to various investment projects that were included on IAWC's application to the IFA, and subsequently approved by the IFA for tax-exempt financing. The use of proceeds from the \$14 million Promissory Note was reported previously.

c) In respect to unapplied proceeds:

As of September 30, 2010, IAWC had no remaining unapplied proceeds from the authorization granted in Docket No. 09-0427. The Company has utilized the full authorization granted by the ICC and, thus, will not issue any additional securities pursuant to this docket.

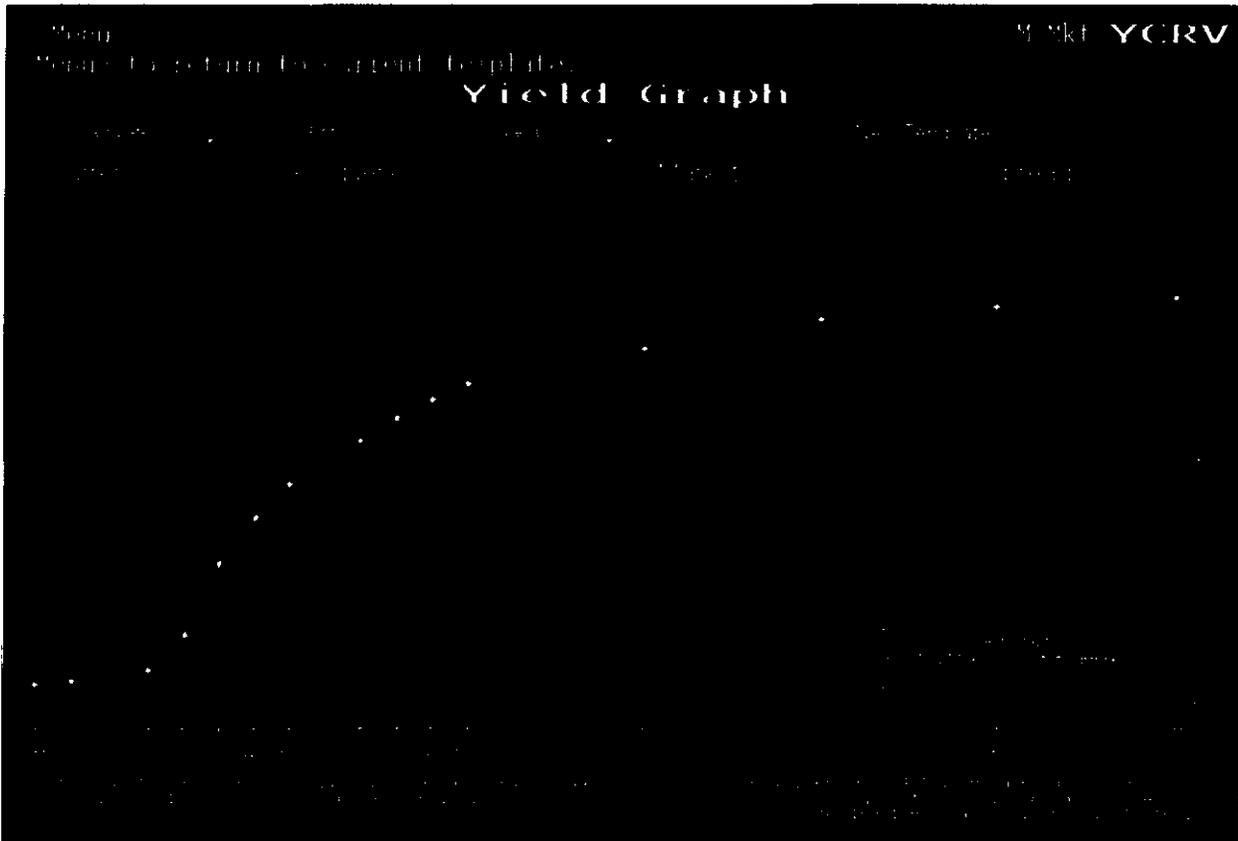
Pursuant to item (ii) of Findings and Ordering Paragraph 8 of the Final Order in Docket Nos. 09-0427, IAWC is required to provide the following:

(ii) a comparison of the issuance costs and interest rate for the Notes issued to AWCC with estimates of the issuance costs and interest rate that IAWC might have incurred had IAWC issued unsecured indebtedness directly to investors.

Debt financing through American Water Capital Corp. ("AWCC"), IAWC's financing affiliate, currently allows IAWC to borrow at a lower interest rate due to AWCC's higher credit rating of BBB+. Regarding IAWC's \$14 million taxable bond, as discussed below, issuing this bond through AWCC lowered the interest rate by approximately 50 basis points because IAWC, on a stand-alone basis, would have a lower credit rating.

The Company's analysis suggests that, based on IAWC's values for the S&P Ratings criteria published in Standard & Poor's RatingsDirect, IAWC's stand-alone credit rating would be between BB+ and BBB-. The graph below shows an approximate 50 basis point yield difference between a BBB+ utility and a BBB- utility. This assumption is based on the spread at the 30 year time horizon for a taxable utility bond, which is consistent with the term of the bond issued by the Company. Thus, issuance through AWCC allowed IAWC to borrow at a rate consistent with a stronger credit rating of BBB+, resulting in a coupon interest rate reduction of approximately 50 basis points.

**Yield Differential Between a BBB+ and BBB- U.S. Utility (Source: Bloomberg 12/1/09)**



**S&P Ratings Criteria**

*Table 1*

| Business Risk | Financial Risk Profile |        |              |            |                  |
|---------------|------------------------|--------|--------------|------------|------------------|
|               | Minimal                | Modest | Intermediate | Aggressive | Highly Leveraged |
| Excellent     | AAA                    | AA     | A            | BBB        | BB               |
| Strong        | AA                     | A      | A-           | BBB-       | BB-              |
| Satisfactory  | A                      | BBB+   | BBB          | BB+        | B+               |
| Weak          | BBB                    | BBB-   | BB+          | BB-        | B+               |

*Table 2*

|                      | Financial Risk Profile |          |              |            |                  |
|----------------------|------------------------|----------|--------------|------------|------------------|
|                      | Minimal                | Modest   | Intermediate | Aggressive | Highly Leveraged |
| Cash Flow/Debt       | Over 60%               | 45%-60%  | 30%-45%      | 15-30%     | less than 15%    |
| Debt/ Capitalization | Below 25%              | 25%-35%  | 35%-45%      | 45%-55%    | Over 55          |
| Debt/EBITDA          | Less than 1.4          | 1.4 -2.0 | 2.0-3.0      | 3.0-4.5    | Over 4.5         |

**II. Credit Statistics**

Years ended 31 Dec

2009      2008      Credit Rating

|                                  |       |       |                    |
|----------------------------------|-------|-------|--------------------|
| Adjusted EBITDA/Interest Expense | 3.1x  | 2.6x  | <b>BBB- to BB+</b> |
| FFO/Interest Expense             | 4.0x  | 3.3x  |                    |
| FFO/Adjusted Debt                | 14.2% | 11.2% |                    |
| Adjusted Debt/ Adjusted EBITDA   | 6.9x  | 8.1x  |                    |
| Adjusted Debt/Capitalization     | 53.0% | 55.6% |                    |

Based on AWCC's current BBB+/baa2 ratings from S&P and Moody's, respectively, and the Company's estimate that, based on the above analysis, IAWC would have been assigned a BBB-rating from S&P if the Company had purchased an S&P rating, the interest rate that IAWC would have obtained on the \$14 million bond issue is estimated to be 6.5%, rather than the 6.00% rate that was obtained by issuing through AWCC. Based on that assumption, the total interest cost savings is \$70,000 annually, which over the life of the bonds is \$2,100,000.

With respect to issuance costs, IAWC benefitted from the fact that its \$14 million debt issuance was part of a larger \$60 million debt financing issued by AWCC. The economies of scale produced by pooling IAWC's debt financing with those of other American Water subsidiaries resulted in lower issuance costs being allocated to IAWC than IAWC would have incurred had it issued the bonds directly to investors. As shown in the table below, the Company's estimate of the issuance cost savings is \$196,090. The table shows the actual issuance costs incurred by IAWC as compared to the Company's estimates of those costs assuming IAWC had issued the bonds directly to investors.

### Actual and Estimated Long-Term Debt Issuance Costs

|                         | AWCC<br>Issuance<br>(Actual) | IAWC<br>Issuance<br>(Estimated) |                |
|-------------------------|------------------------------|---------------------------------|----------------|
| Face Amount of Issuance | \$ 14,000,000                | \$ 14,000,000                   |                |
| Underwriter's Discount  | \$ 441,000                   | \$ 441,000                      |                |
| Bond Ratings            | 30,100                       | 140,000                         |                |
| Trustee                 | 1,983                        | 5,000                           |                |
| Trustee Counsel         | 1,447                        | 6,000                           |                |
| Company Counsel         | 14,129                       | 60,000                          |                |
| Local Counsel           | 8,760                        | 8,760                           |                |
| Printing                | 2,970                        | 12,000                          |                |
| Accountant's Fees       | 7,282                        | 31,000                          |                |
| ICC Fee                 | 33,600                       | 33,600                          |                |
| <br>Total               | <br>\$ 541,271               | <br>\$ 737,360                  |                |
| <br>Difference          |                              |                                 | <br>\$ 196,090 |

This completes IAWC's reporting related to the \$14 million bond issue. The Company will continue to file reports related to the \$25 million bond issue until it has completed the reimbursement process with the IFA.

Dated December 2, 2010.

ILLINOIS AMERICAN WATER COMPANY

By:   
 Edward J. Grubb  
 Assistant Treasurer  
 Illinois American Water Company

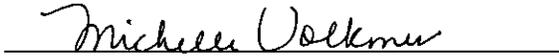
**VERIFICATION**

Edward J. Grubb, Assistant Treasurer of Illinois American Water Company, being first duly sworn, deposes and states that he is familiar with the facts stated in the foregoing Special Report and that said facts are true and correct to the best of his knowledge, information and belief.



Edward J. Grubb  
Assistant Treasurer  
Illinois American Water Company

SUBSCRIBED and SWORN to before me this  
2nd day of December, 2010.

  
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Notary Public